

9. OWNERSHIP INTERESTS AND FORMS

Before a church organization decides whether or not to accept non-cash property as a proposed gift or transfer into trust, it is critical to ascertain how property ownership is held, who or what owns the property, what is actually owned, as well as, how ownership is to be transferred.

A number of forms of property ownership exist. These forms of ownership apply not only to real property but may apply to personal property as well. Planned Giving & Trust Services personnel should acquaint themselves with the various forms of ownership as they will not only be involved with the transfer of property, but will, in all likelihood, be questioned by constituents who do not have a clear understanding of their ownership interest.

A. Ownership Interests, Generally

As a general rule, real estate may be held in either entire or partial interests, directly or indirectly. An entire interest occurs when ownership is vested solely in one person or entity. Accordingly, a partial interest occurs when ownership is concurrently or consecutively shared by two or more individuals or entities; each sharing a portion of ownership in some legal manner. Individuals directly own property when title is held in their name and indirectly when title is instead held by a separate legal entity in which the individual has an interest, as discussed in Section E below.

B. Entire Ownership Interest

Fee Simple Absolute. In many cases, the owner holds the property in “fee simple”. Fee simple (or simply “fee”) is the largest estate known to the law. It denotes maximum legal ownership, the greatest possible aggregate of rights, powers, and privileges that a person may have in land. These rights include possession, control, enjoyment, and disposition. The owner is entitled to the entire property with unconditional and unlimited disposition during life and descending to the heirs at death. Although fee simple provides the most complete interest in property to the owner, these very broad rights are limited by governmental ordinances and statutes. All other ownership rights consist of partial or indirect interests.

C. Types of Interests in Land

1. Undivided Interest. Joint owners are often said to have an undivided interest. An undivided interest in property is defined as interest in property owned by one or two or more tenants in common or joint tenants, before partition. The interest is held by the same title—by two or more persons—whether their rights are equal (in value or quantity) or unequal. The undivided interest is a fractional interest whereby each owner co-owns each and every right to the same property at the same time in their relative proportions.

2. Present Interest and Future Interest. A beneficial interest may be classified as either a present or future interest, depending on whether the owner has the immediate right (present interest) to possess or enjoy the property. The right of the owner of a future interest to possess and enjoy the property is delayed for a specific time period or until a certain event occurs. For example: Ted creates a revocable living trust and retains the right to possess and

enjoy the real estate titled to the trust for his lifetime. Ted's interest is a present interest. The Trust further directs that upon Ted's death the real estate is to be conveyed to Joan and Sylvia. Joan and Sylvia have future interests.

3. Future Interests. Future interests are the present right to future use and enjoyment of property which will take place upon the termination of a prior estate. The most common future interests are reversionary and remainder interests and can be either vested or contingent.

a. Reversionary Interest. A reversionary interest occurs when an owner transfers less than full rights in the property and reserves the right to get the property back at some time in the future. If the transferor is alive at the appointed time, the property will revert back directly to the transferor; if not, then to the transferor's estate. Reserving a reversionary interest does not mean the transferor retains the right to the use and enjoyment of the property. The reversionary interest is only the right to receive property ownership when the term of the estate transferred terminates. Consequently, it is a future interest. For example: John transfers property, in trust, to Mildred for her life. At her death the property comes back to John, if alive, or to his estate. John has a reversionary interest.

b. Remainder Interest. A remainder interest in property occurs when an owner transfers less than entire ownership in property and provides that the property will go to a third party at some time in the future. The remainder owner will be someone other than the grantor or life tenant. For example: Jack conveys the family farm to Susan subject to a life estate for Bill. Susan is the owner of the future remainder interest. She has no rights to possess, use or enjoy the property until the termination of Bill's life estate.

c. Vested Future Interests. A vested future interest is one that is not forfeitable. It is an interest the possession and enjoyment of which is delayed *only by time* and is not dependant on the occurrence of a future event. As in the example above, Susan's remainder interest is *vested* because there is nothing to prevent Susan or her estate from receiving possession except the passage of time. With the passage of enough time Bill will die and the remainder interest will mature to Susan or her estate.

d. Contingent Future Interest. A contingent future interest is one that is not vested. It is an interest the possession and enjoyment are dependant on the happening of a future event, not on just the passage of time. For example: When James died, his will directed all of his probate assets be invested to earn income for his daughter Jill. At Jill's death, the assets are to be distributed to William if he survives Jill, otherwise to the General Conference. William and the General Conference hold contingent future interests. William's possession of the property is dependant on his being alive when Jill dies. The General Conference's interest is contingent on William predeceasing Jill.

D. Consecutive and Concurrent Joint Ownership

1. Life Estate (consecutive ownership). When there is a life estate, the fee interest in the property is divided between two or more parties, typically a life tenant and the owner of

the reversionary or remainder interest. The owner of the life estate (“life tenant”) is given the right as to possession, control, income, and enjoyment of the property for a period of time measured by the life of the life tenant or by the life of another person (“measuring life”). Upon conclusion of the measuring life, the life estate terminates or is extinguished and title then vests entirely in the remainder or reversionary interest holder.

The life tenant bears responsibility to prevent waste through any activity that will diminish the value of the remainder or reversionary interests. Generally, the life tenant must insure the property, pay all taxes, and provide for normal maintenance and upkeep. A life tenant can convey his/her interest in the property to a third person for a term less than or equal to but not greater than the duration of his/her own estate, that is, the term of the measuring life. If a life tenant voluntarily makes improvements, the remainder owners cannot be forced to share the costs of such improvements.

2. Estate for Years (consecutive ownership). As with the life estate, when there is an estate for years, the fee interest in the property is divided between two or more parties, typically the owner of the estate for years and the owner of the reversionary interest. The estate for years is similar to the life estate in that the owner of such an estate has the temporary right to possession and enjoyment of the property, but for a specifically stated number of years, rather than the indefinite period of a specified lifetime. Upon expiration of the stated number of years, the estate for years is terminated and title then vests entirely in the remainder or reversionary interest holder. Like the life tenant, the owner of an estate for years must not diminish the value of the future interests and must protect and maintain the property. If he/she voluntarily makes improvements to the property, the remainder owners are not obligated to share the costs of such improvements. The owner of an estate for years may convey his/her interest in the property to a third person, but, again, only for a term less than or equal to the duration of his/her own estate.

3. Tenancy in Common (concurrent ownership). Tenancy in common is a form of ownership in which each “tenant”, or co-owner, holds an undivided interest (may expressed as a fraction or percentage) in the property. The sizes of the interests do not have to be equal, but often they will be proportional to the number of co-tenants. Upon the death of one tenant, the decedent’s interest passes to the deceased’s heirs, not to the other co-owners.

4. Joint Tenancy (concurrent ownership). Joint tenancy is a form of ownership by two or more parties whereby each holds an *equal* and undivided interest in the whole property, acquired at the same time and by the same instrument. A joint tenancy ownership interest includes the right of survivorship, the operation of which results in a deceased joint tenant’s interest automatically passing to the surviving joint tenant(s). In some jurisdictions the right of survivorship is inherent simply when title is taken as joint tenants. In other jurisdictions, the intent for the right of survivorship to attach must be clear at the creation of the title; otherwise a tenancy in common is created. Some jurisdictions require the express wording “with the right of survivor ship” be used when taking title in order for the right to attach.

Because of the right of survivorship, a joint tenant cannot transfer his or her share to another by bequest. However, the joint tenant has the right to convey or transfer his or her interest in the property to another during life and has the right to compel a partition sale without the consent of

any other joint tenant. However, the transfer by a joint tenant of his/her interest to a third party terminates the joint tenancy as between the transferor's interest and the interest(s) of the remaining tenant(s), creating a tenancy in common.

5. Tenancy by the Entirety (concurrent ownership). Tenancy by the entirety is a form of joint tenancy that exists in many states, but not all of them. It is a special form of joint tenancy between married persons. If no survivorship is specified, a tenancy in common results. It is also possible to have a joint tenancy with right of survivorship between spouses, if the tenancy by entirety is not specified. The death of one tenant vests the entire ownership in the survivor automatically. Neither tenant can alienate (transfer) entirety property without the joinder (cooperation or agreement) of the other tenant. In other words, while both husband and wife are alive and married, property can be sold only with the consent and signature of both. Neither tenant may compel a partition of the property. Entirety property is immune from the creditors of either tenant during the lifetime of the non-debtor spouse, but not from the creditors of both tenants.

The tenancy by the entirety terminates upon a joint conveyance by the spouses. Because marriage is a requirement to hold title in this manner, divorce converts the tenancy by the entirety into a tenancy in common.

6. Community Property (concurrent ownership). A handful of states have a form of co-ownership of property between married persons known as community property. Those states currently are Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington. Additionally, the state of Wisconsin has a form of marital property similar to community property, but not designated as such. Alaska is an "opt in" community property state, allowing married persons to designate property as community property by written agreement. Details vary widely between community property jurisdictions. Generally, however, property owned by married persons is characterized as either "community" or "separate." Property that each spouse owns prior to marriage or receives during the marriage by gift or inheritance is that spouse's separate property. All other property acquired during the marriage, including wages and other compensation for services, is community property. Separate property can be "transmitted" into community property by written agreement between the spouses. When separate or community property assets are used to purchase or otherwise acquire new or different assets, the new or different assets retain the character of the assets used to acquire them, and, any income derived from community assets is community property. However, whether the income derived from separate assets is separate or community property varies from state to state. The rights of creditors of one spouse to reach a couple's community property also vary.

Each spouse technically owns an undivided one-half interest in the couple's community property. Each spouse may convey during life or bequeath at death his or her interest in the couple's community property to another. Upon the death of a spouse, in the absence of a bequest to another party, the deceased's interest in the community property passes to the surviving spouse.

Some community property states also recognize the concept of "quasi-community property," generally defined as property acquired by either spouse while domiciled in a non-community

property state that would have been community property had it been acquired while domiciled in a community property state. The concept of quasi-community property typically only comes into play upon divorce of the couple or death of one of the spouses, in which event, if occurring while domiciled in a community property state, the quasi-community property is treated as community property.

E. Indirect Forms of Ownership

Indirect ownership exists when title to property is not held by an individual, but is held by a legal entity in which the individual has an interest.

1. Partnership Interests. A partnership is an association of two or more persons for the purpose of carrying on a business as co-owners. There are various types of partnerships available, including general partnership and limited partnership.

a. The general partnership imposes unlimited personal liability upon each general partner. If the partnership cannot fulfill a contract or business deal, each partner may be held personally liable for the amount owed.

b. Limited Partners. One or more partners contribute capital to the business. Limited partners neither participate in its day-day operations nor have personal liability for business debts and claims. Limited partnerships must be formed by two or more people with at least one person acting as the general partner, who has management authority and personal liability and the other in the role of limited partner.

Planned Giving & Trust Services personnel should exercise great caution and at all times consult with knowledgeable professionals before receiving partnership interests as gifts or transfers into trust. Church entities could be subjected to partnership indebtedness, expense, liability, income tax and unrelated business income tax.

2. S Corporations. S corporations are those corporations electing tax treatment under Subchapter S of the Internal Revenue Code. In form, an S corporation acts as a conduit very similar to a partnership. Items of income, expense, and credit retain their character as they are passed through to shareholders. All income is taxed to the shareholders each year. There may not be more than 35 shareholders, and the S corporation may not have more than one class of stock. Subchapter S stock may not be transferred to a Charitable Remainder Trust.

3. C Corporations. The most widely used form of ownership for large businesses is the C Corporation. There are a number of advantages to this form of business ownership, among which are: limited personal liability, perpetual life, generally unrestricted transfer of ownership interests, relative ease of acquiring capital, and constitutional rights to the business.

There are also significant disadvantages, among which are: the significant time and energy requirements of shareholders, directors, and management to maintain the corporate status, the generation of much paperwork, the expense required to run the corporation, limitations in ability

to cross state lines for conduct of business, less flexibility than provided by other forms of business, the oppression of minority stock holders by those in the majority, and double taxation.

4 Limited Liability Company. A limited Liability Company (LLC) is an entity formed under state law. Unlike a general partnership, none of the members of a LLC are personally liable for the LLC's debts. For income tax purposes a LLC may be classified as a partnership or corporation. If classified as a partnership there is a pass through of the tax characterization of the distributive share to the member. Gifting of such interests can create adverse tax consequences to the charity or charitable remainder trust.

5. Cooperative Housing Corporations. A "co-op" is a form of indirect ownership whereby property (typically multi-family residential) is acquired by a cooperative housing corporation. The purchase may be financed by a combination of conventional financing and sale of shares to prospective tenants. In essence the tenant-shareholder holds a proprietary lease providing tenancy to a particular residential unit. The shareholder interest is subject to the liens, debts, and obligations incurred by the corporation.

6. Trust. Usually, a property owner has all the rights to possess and enjoy it. Property titled "in trust" divides ownership rights, so that one party (the Trust or Trustee on behalf of the Trust) holds "bare legal title" wherein the Trustee is responsible for managing and preserving the property for the benefit of another, and a second (or more) party is entitled to enjoy the property in specified ways. The former holds the legal interest, while the latter holds the beneficial or equitable interest in the property. The Trust would have direct ownership and the beneficiary (either lifetime or remainder) would have an indirect interest.

F. Condominium

A condominium is a type of joint ownership of real property in which portions of the property are commonly owned and other portions are individually owned. The abbreviated term "condo" is often used to refer to the individual dwelling unit itself in place of the term "apartment" in order to clearly signify property ownership. Condominiums are commonly owned in fee simple title, but can be owned in ways other real estate can be owned either directly (e.g. joint tenant) or indirectly (in trust, by a partnership).

Typically, a condominium consists of units in a multi-unit dwelling where each unit is individually owned and the common areas like hallways and recreational facilities are jointly owned by all the unit owners in the building. It is possible, however, for condominiums to consist of single family dwellings: so-called "detached condominiums" where homeowners do not maintain the exteriors of the dwellings, yards, etc. or "site condominiums" where the owner has more control over the exterior appearance.

A homeowners association or condominium association, consisting of all the members, manages the common areas usually through a board of directors elected by the members.